



# AFSCME®

**American Federation of State, County and Municipal Employees**

1625 L Street, N.W., Washington, D.C. 20036

Telephone (202) 429-1000

Telex 89-2376

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Statement of  
  
the  
  
American Federation of State,  
  
County and Municipal Employees, AFL-CIO  
  
Before the  
  
Committee on Post Office and Civil Service  
  
U.S. House of Representatives

March 6, 1984

Mr. Chairman and distinguished members of the Committee on Post Office and Civil Service, I am William B. Welsh, Director of Legislation of the American Federation of State, County and Municipal Employees (AFSCME). We are here representing more than 13,000 employees of the Federal Government and the District of Columbia who participate in the Civil Service Retirement System (CSRS) and approximately one million members of AFSCME who work at various levels of government across the nation.

We commend the Committee for commencing a series of hearings focusing on the development of a new retirement system for Federal employees who are subject to Social Security. We are confident that the Committee recognizes the complexity and sensitivity of this task.

As a union which represents workers not only in the Federal Government but in state and local governments, we have a broad range of experience in working on pension design issues at the state and local level. We know that public pension systems, as creatures of the political process, present unique challenges in plan design and funding. We know that design of a new public pension system involves addressing very important policy questions concerning the kind of workforce you want to recruit and retain. How the Committee resolves these issues ultimately will have important ramifications not only for current and future generations of Federal workers but also for the taxpaying public and its expectations regarding Federal employee productivity.

Our testimony today focuses on several of the key threshold questions involved in planning the design and objectives of the new retirement system. At subsequent points in the ongoing process of developing the new system, we expect to present our views on other important design and funding issues.

First, we believe the new plan must have benefit levels which when combined with Social Security are at least comparable to those currently provided under CSRS. In this regard, we strongly share the view of Speaker Thomas P. O'Neill, Jr. , Chairman Ford and Ways and Means Committee Chairman Rostenkowski, expressed in a February 18, 1983 "Dear Colleague" letter, that the participants in the new system". . . should be provided retirement benefits comparable to those under CSRS" and that benefits should not be reduced or employee contributions increased for employees participating in the current system. Moreover, it should be noted that the legislative history of Public Law 98-21, the Social Security Reform Act of 1983, lends ample support to the proposition that Congress, in extending Social Security coverage to new Federal employees, clearly intended that they receive comparable benefits.

At the same time, special care must be taken to ensure that the career and retirement income needs of lower paid Federal workers are met. Accordingly, we believe that mandatory employee contribution levels, when combined with Social Security tax payments, should be no higher than currently required under CSRS.

The enactment of a new plan with a significantly different benefit structure and other substantive differences would be inequitable and disruptive of employee morale. Various state and local government employees have established new retirement systems or "tiers" with substantially reduced benefits for newly hired workers. As a result, employees performing the same duties receive markedly different total compensation because of different pension benefits, a consequence of arbitrary hiring dates. Not only has this created significant employee morale problems but it has greatly complicated the task of running such systems due to the administrative problems involved in operating two or more retirement systems for the same class of employees.

The second major point we want to make today concerns the various compensation elements which the Committee should consider in making appropriate comparisons to other sectors of the economy. In designing the new system, we believe that you need to refer to the widest range of compensation elements, including salaries, other forms of cash compensation and fringe benefits. While there are some significant methodological and data collection problems involved in comparing public and private sector benefit and cash compensation practices, we are confident that the Committee can overcome these problems.

When comparisons between Federal and private sector benefits and cash compensation are made, we believe they will indicate

that Federal workers generally receive less compensation than their counterparts in the private sector. A recent study by the Congressional Budget Office (CBO), conducted for the Committee, indicates that fringe benefits for Federal white-collar employees lag behind those of white-collar employees in the private sector. 1/

The CBO study was preceded by a study of Federal health benefits, performed by William Mercer, Inc., which found Federal health benefits to be significantly inferior to those offered by private sector employers. 2/ At the same time, computations made pursuant to the current Federal pay-setting method indicate that Federal white-collar pay averages about 22 percent below prevailing levels in the private sector. 3/

Placing retirement benefits within the context of total compensation practices will help the Committee focus on what should be the most fundamental and overriding policy question involved in this process - what kind of a workforce does the Government of the United States seek to attract and retain? As noted in the February 23, 1984 statement of Kenneth Shapiro of Hay/Huggins, Inc. before the Committee, "(i)t is important to have a total compensation system, including a retirement system, that allows the employer to attract, retain and motivate the type of employee that will best serve the organization. "

We urge the Committee at the onset of this process to directly address this subject. "Employee benefit plans are not

philanthropy but good business. They are intended to attract and retain the best employees, to encourage a career commitment, to promote good employee relations and thereby increase productivity. "4/ If it determined that the Federal Government continues to require career employees of uncommon ability, then fair and attractive compensation and benefit programs presumably must be put in place to attract and retain individuals of this caliber.

Finally, based on our experience at the state and local government level, we offer some brief observations on certain design and funding issues which may be helpful to the Committee. We note that there has been considerable discussion regarding possibly adopting a defined contribution plan as the centerpiece of the new system. In our view, this would be a major mistake. For compelling reasons, practically all workers in the public sector - and most in the private sector - participate in defined benefit plans. Employees and the nation as a whole, according to a recent Pensions and Investment Age editorial, would be the losers if there was a significant shift from defined benefit to defined contribution plans. 5/

Defined benefit plans are the most effective way to provide workers and their families with a predictable and adequate source of income protection in the event of retirement, disability or death. In sharp contrast, defined contribution plans offer

employees considerably less income protection and do not lend themselves to simple computation of benefits to employees. A recent article in the Management Information Service Report which summarizes our views on defined contribution plans is set forth below as Attachment A.

Once the general type of plan is selected, the Committee must determine the extent to which the Social Security benefit is coordinated with the pension benefit formula. At the state and local level, AFSCME has strongly opposed the use of the "offset" approach by which a portion of an employee's Social Security benefit is deducted from what would otherwise be payable under the pension plan. While the offset method may still be widely used in the private sector, we have seen a definite trend away from its use in the public sector. In short, offset plans are extremely unpopular with both public employees and employers. Its disadvantages are that it cannot be readily explained and understood by plan participants and it is not possible to calculate the benefit of an employee until the Social Security benefit is calculated and made known to the employer. Moreover, at the state and local level, it has frequently resulted in lower paid workers receiving little or no pension benefit at all.

While the private sector perspective is important, we believe the Committee should keep in mind the major differences between public and private sector plans, particularly as they relate to policy questions concerning financing of the new system. In our view, a different funding philosophy or standard should prevail in the public sector than that imposed on private plans by Public Law 93-406, the Employee Retirement Income Security Act of 1974 (ERISA). It should be based upon the assumption of perpetual operation of the unit of government. Despite views to the contrary expressed in the wake of New York City's fiscal crisis, the Federal Government and state and local governments are still not likely to go out of business. They fill an indispensable need. In contrast, experience has demonstrated the likelihood that most private employers will eventually terminate operations; the life expectancy of the average private business in the United States is less than the working life span of the average American worker.

This is not to suggest that public employee pension plans should defy accepted actuarial principles. To the contrary, AFSCME has been a strong proponent of advance or reserve funding of pension obligations and of the enactment of minimum federal reporting, disclosure and fiduciary standards for state and local government pension plans. We merely suggest that the Committee should take note of the substantive differences between public and private plans in resolving financing questions. Robert



Tilove commented on this issue in his major study on public employee plans:

The logic (of full funding) is that the fund should be able to pay all accrued benefits if the plan is terminated.

But if termination is not a real danger, if a state or other unit of government can reasonably assume perpetual life and ability to pay, then achievement of a full funded position is a questionable standard.

This position is quite different from many widely held views on what is necessary for the "actuarial soundness" of a public plan. There are many advocates of the view that the only proper course for a public employee system is to follow a schedule directed to full funding. By that they mean that the past service, accrued, or supplemental liability should be completely amortized within some reasonable period. . .

Those who regard full funding as sacrosanct often make use of other value-colored words. The unfunded accrued liability is often referred to, in reports or headlines, as the "deficiency" or "deficit". The impression conveyed is that it is an item of fiscal unsoundness, that it must not increase, and that it should be eliminated as soon as feasible. . . there is nothing necessarily improper or unsound about a continuing (but not growing) unfunded liability. . .

A public employee system can continue in perpetuity, can discharge all its obligations, and can be financed on a level contribution rate fully reflective of its ultimate disbursement needs, without ever achieving or attempting to achieve a "fully funded" position, as that has traditionally been defined. 6/

We thank the Committee for the opportunity to present this statement, and we look forward to continue working with you on this extremely important matter. We would be pleased to answer any questions you may have.

Attachment A

FOOTNOTES

1/ Adjustments in Federal White Collar Pay: A Technical Review of Best Proposals and the Outlook for October 1983, Committee on Post Office and Civil Service, Committee Print 98-4 (March 22, 1983).

2/ Review of the Federal Employees Health Benefits Program, Committee on Post Office and Civil Service, Committee Print 97-8 (July 13, 1982).

3/ Jerome M. Rosow, "Stop Exaggerating Federal Pay," Washington Post (September 2, 1983), p.A20.

4/ A. Dale Statton, "The Retirement Income System: Design Issues," testimony submitted to the Policy Forum on Federal Retirement, Senate Committee on Governmental Affairs (February 10, 1984), p.1.

5/ Pensions and Investment Age (December 20, 1982), p.4. This assertion is made because it is felt that overall national savings rates might decrease, and if defined contribution plans could not contribute adequately to a person's retirement, an additional burden would be placed on the Social Security system.

6/ Robert Tilove, Public Employee Pensions Funds (New York: Columbia University Press, 1976), pp. 1655-66.

**Management Information Service**

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**Reforming Public Pension Plans****DEFINED CONTRIBUTION  
PLANS—A LABOR VIEWPOINT**

There is no dispute concerning the proposition that state and local government pension plans urgently require understanding and reform. Whether one looks to the comprehensive report on public plans issued in 1978 by the House Education and Labor Committee or to a host of other private and government studies, it is clear that a crisis now exists in the operation of state and local government pension plans. These plans face problems that threaten not only their own fiscal stability and the rights and interests of the workers who contribute to them, but threaten as well the financial health of state and local governments.

In congressional hearings that were held last year on legislation that would establish minimum federal reporting, disclosure, and fiduciary standards for state and local government retirement systems, witness after witness came to the same essential conclusions:

- Many public pension plans are dangerously underfunded and have accumulated staggering amounts of unfunded liabilities.
- All too frequently, important information on these plans' benefits and financial condition is not disclosed regularly to participants, to public officials, or to the taxpayers.
- The investment and management practices of many state and local plans are wholly inadequate to safeguard assets; they come nowhere near what is expected, and what is in fact, required in the private-sector pension community.
- The fiduciary protections for public plan participants are far less than they should be.
- A coherent federal regulatory framework that recognizes the unique characteristics of state and local plans has yet to be established.

Reforming public pensions will require a variety of steps at both the federal and the local levels, involving the cooperation of employers and employees. But certainly the answer to the public pension crisis is not to be found in replacing defined benefit plans with defined contribu-

tion plans. For compelling reasons, the great majority of workers in both the public and private sectors participate in defined benefit plans. According to a recent *Pensions and Investment Age* editorial, employees and the nation as a whole would be the losers if there was a significant shift from defined benefit to defined contribution plans.<sup>1</sup>

Defined benefit plans are the most effective way to provide workers and their families with a predictable and adequate source of income protection in the event of retirement, disability, or death. In sharp contrast, defined contribution plans offer employees considerably less income protection and do not lend themselves to simple computation or communication of benefits.

Benefits payable under a defined contribution plan are based solely on the balance in the individual worker's account at the time of retirement. As noted by Professor McGill in his treatise on pension plans, several inherent weaknesses stem from this arrangement.<sup>2</sup>

First, a uniform rate of contributions established for all employees in a jurisdiction cannot possibly result in a benefit that is appropriate for workers who enter the plan at varying ages. For example, a rate that would result in an adequate retirement benefit for a long-time plan participant would not result in an adequate benefit for a worker who has participated in the plan for a relatively shorter period. Accordingly, contribution rates would have to be varied by age of entry into the plan "... which may raise questions of equity in the minds of the employees."

Second, McGill also points out that the contributions made on behalf of a worker in the earlier years of service when wages are generally lower are given relatively greater weight than the contributions made in later years when the wages are higher. This is due to compounding, or the earning of interest on interest. The resulting benefit frequently will be inadequate, particularly during periods of sustained inflation.

A third major weakness associated with defined contribution plans is that the investment risk is in effect transferred to the employee. In most defined contribution plans, the employee is given the responsibility for choosing how to invest the funds contributed on his behalf. If the employee guesses right, he or she will receive a decent benefit, but if he or she guesses wrong, retirement savings may be inadequate. Essentially, the employee is more directly dependent on the performance of plan investments.

Clearly, employees are the losers if state and local governments move to defined contribution plans. It is not appropriate to expect workers to assume all of the investment risk for their retirement. Defined benefit plans with their guarantee of a certain retirement income regardless of the performance of the economy or plan investments remain for both the public and private sectors the best way to provide employees with an adequate source of retirement income.

<sup>1</sup> *Pensions and Investment Age*, Dec. 20, 1982, p. 8. This assertion is made because it is felt that overall national savings rates might decrease, and if defined contribution plans could not contribute adequately to a person's retirement, more burden would be placed on the Social Security system.

<sup>2</sup> Dan M. McGill, *Fundamentals of Private Pensions*, 4th Edition, 1979, pp. 98-101.

<sup>3</sup> *Ibid.*, p. 99.

*This article was prepared by Charles M. Loveless, Counsel for Employee Benefits, American Federation of State, County and Municipal Employees (AFSCME).*